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POLICY MEASURES FOR DOMESTIC RESOURCES MOBILIZATION

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I. INTRODUCTION

1. As is spelled out in paragraph 23 of the International Development Strategy for the Third United Nations Development Decade, "The acceleration of production in the developing countries will require that gross investment reaches the level of about 28 percent of gross domestic product by 1990. The developing countries, therefore, must fully mobilise their domestic financial resources. To this end, for developing countries in general, gross domestic saving should be increased to reach about 24 percent of gross domestic product by 1990. The developing countries that have a saving ratio of less than 15 percent should make rigorous efforts to raise it to 20 percent as early as possible. The countries that have or will soon have a saving ratio of 20 percent should raise it significantly during the Decade" 1/.

2. The Lagos Plan of Action (LPA) and the Final Act of Lagos (FAL), the African Priority Programme for Economic Recovery (APPER) and the United Nations Programme of Action for Africa's Economic Recovery and Development 1986-1990 (UN-PAAERD) have also emphasized that African countries should continue to bear the main responsibility for financing their development and should adopt vigorous measures for a fuller mobilisation of their domestic financial and physical resources 2/. A successful savings mobilisation would require a mix of complementary government policies directed towards the optimization of the saving patterns of the country and the most efficient allocation of savings to productive investment. These also entail the reduction of capital flight through a realistic, manageable exchange rate.

1/ UN, The International Development Strategy for the Third United Nations Development Decade (A/35/464), 23 October 1980, p. 6.

2/ See OAU, The Lagos Plan of Action for the Economic Development of Africa 1980-2000, ILO, Geneva, 1981; OAU, The African Priority Programme for Economic Recovery 1986-1990 (APPER), Addis Ababa, Ethiopia, 1985, and UN, The United Nations Programme of Action for African Economic Recovery and Development 1986-1990 (UN-PAAERD), May 1986, in which African countries committed themselves to mobilizing 64.4 percent of US$128.1 billion investment requirements from domestic resources.

3. This paper presents a general framework for the formulation of a range of policies for the mobilization of domestic resources and their efficient utilization. The paper outlines the importance of domestic resources mobilisation in general, reviews the savings performance in Africa during the period 1960-1988, proposes the major policy measures for increasing the mobilization of domestic resources, and examines the feasibility of realizing the saving ratio of 25 percent of GDP for Africa as a whole in the 1990s if the above proposed measures are fully implemented.

II. THE NEED FOR DOMESTIC RESOURCE MOBILIZATIONS

4. The need for domestic resource mobilisation arises directly out of the need for investment and capital formation at progressively higher levels; and until sufficient resources are mobilised by cutting down on immediate consumption, the objectives of attaining rapid economic development cannot be attained. Savings are, therefore, of paramount importance for attaining desired rates of growth. Domestic saving for investment can, of course, be potentially supplemented by external financing in the form of foreign aid, loans, direct foreign investment, etc. The experience of the last two decades shows that only in few African countries, domestic savings had financed the bulk of investment, while the majority of African countries have continued to rely heavily on external financing 3/. The inability to raise adequate revenues because of the low per capita income of the population in general, the institutional weakness in the machinery of tax collection, the misallocation of public resources between capital and recurrent budgets and the substantial operating losses of public enterprises and consequent drains on the treasury, and subsidies of various kinds have reduced the size of the domestic savings and mitigated towards heavy reliance on external sources of financing investment. But there has been a growing awareness that the continuing adverse international economic situation over the past few years has diminued prospects for the continuous reliance on increased external financial assistance at anywhere near past levels. In the real terms, such an inflow of external capital has, in fact, been declining. This suggests that the limit of the growth of output in African countries has been set by the limited rate of growth of their domestic savings and the external financing.

3/ See ADB/ECA Economic Report on Africa 1985, March 1985, pp. 13-19; and Economic Report on Africa 1987, March 1987, pp. 26-27.

5. Indeed, the volume of savings in Africa is not enough to meet high investments for self-sustained development, either because of the low level of savings in general, or because only a portion thereof becomes available for productive investment. Consequently, major bottlenecks developed in the process of capital formation and the drive for development.

6. The African countries should intensify their efforts to mobilize domestic savings from the household, business and government sectors, so as to maximize financial resources available for accelerated development. The household savings are generally derived from salaries, wages and professional fees and profits; while the business savings are derived from undistributed profits and the government savings are derived from taxation. The government objective in the achievement of a better quality of life for the population at large through a more equitable spread of the benefits of economic growth, calls for an increased government's responsibility with regard to investment, and hence to seek to generate a larger volume of public savings through taxation and the profits of public enterprises and provide an enabling environment for raising the private sector's savings.

7. The experience shows that in the majority of the African countries, government savings, defined as the excess of current revenue over current expenditure, has been insignificant if not negative. There have been persistent and significant increasses in the volume of government consumption, notwithstanding current adjustment programmes adopted and implemented by some African countries. The prevailing tax regime, itself the result of structural deficiencies, severely limits the realization of the savings potential. The financial efficiency of public enterprises presents a dismal picture in many countries, and a majority of the parastatals despite subsidies of various kinds have been incurring losses since 1980, largely due to unsatisfactory pricing policies imposed on them. These enterprises generally have a deficit rather generating a surplus and contributing to domestic savings. Indigineous private corporate savings also are insignificant because of the smallness of this sector and multinational corporate savings in some cases leak outside the continent through transfer abroad of dividends, profits, interests, etc.

8. The savings of non-corporate private sector (personal or household savings) are of crucial significance for transfer to the public and corporate sectors for investment. However, the level of current income is a significant determinant of household saving, the actual savings/income ratio being determined by attitudes towards consumption. The main issue relates not

merely to the motivation to save but the motivation to save in financial assets rather than in physical assets, such as gold, land, cattle and commodity inventories, etc. The degree of motivation to save in financial assets is interlinked with not only the extent of the spread of thrift and the banking habit, the existence of appropriate institutional infrastructure and the availability of choice of savings instruments (liquidity of funds and return on funds invested), but also with the degree of their accountability to the public.

9. The key question is whether an effective and integrated financial system for transfering and allocating resources to, and ensuring their efficient use in, sectors that are crucial for implementing the country's development strategy and programmes is already well developed or is yet to evolve. It is clear that the relative importance of all the factors that influence household savings and the weight that should be attached to them for promoting household savings for development vary from country to country, depending upon the prevailing socio-economic conditions, the country's policy and programmes and the stage of its development.

10. In general, however, the need for reliance on domestic sources for financing the bulk of development expenditures has never been as crucial as it is during the decade of the 1980s. The mobilisation of adequate financial resources has posed a serious challenge for the African governments for the implementation of investment projects and programmes in the 1980s. African countries are left with no choice but to adopt an attitude of increasing self-reliance in the decades ahead.

III. THE GROWTH AND PATTERN OF GROSS DOMESTIC SAVINGS IN AFRICA

11. One of the major challenges facing African countries today relate to capacity to generate enough resources to finance and administer their development efforts. For developing Africa, as a whole, the share of gross domestic savings (GDP - total consumption) in total GDP increased from the level of 12.4 percent in 1960 to 18.6 percent in 1980 but it declined to 17.5 percent in 1988 (see table 1).

Table 1: The Pattern of Gross Domestic Savings in Africa 1960-1988

(Percentage of GDP at constant market prices)

Geographical/Income Subgroups	1960	1970	1980	1985	1988
North Africa	12.1	21.4	16.2	16.1	16.6
West Africa	9.4	12.9	21.2	16.2	16.7
Central Africa	15.6	19.5	19.6	19.7	20.5
East and Southern Africa	14.6	15.0	17.5	14.4	15.0
Major Oil Exporters	13.5	22.5	35.1	26.5	28.7
LDCs	6.6	10.3	4.0	4.6	4.9
Others	19.0	16.0	17.4	19.3	18.7
Developing Africa	12.4	17.8	18.6	16.8	17.5
(Asia)	19.1	25.4	30.3	26.3	na
(Latin America)	19.5	21.6	22.0	22.1	na

Data Source: ECA, 25 Years of Service to African Development and Integration, Addis-Ababa (Ethiopia), 1983 Statistical Appendix; Survey of Economic and Social Conditions in Africa, Various issues from 1980 onward; ECLA, Statistical Yearbook for Latin America and the Caribbean, Various issues from 1980 onward; and UN, National Accounts Statistics; Analysis of Main Aggregates, 1985, New York, 1988.
E= Estimates
na= Not available

However, as the level of domestic savings is, in accordance with the Keynesian economic theory, mainly determined by income levels among other factors, the savings efforts in the African region vary considerably from one income group to the other. The major oil exporters, Algeria, Gabon, the Libyan Arab Jamahiriya and Nigeria, for instance, were able to raise their savings ratios from about 13.5 percent of GDP in 1960 to 35.1 percent of GDP in 1980 as a result of oil boom in the mid-1970s although such a saving level significantly declined to 23.7 percent in 1988, due to recent strides in oil prices.

12. The savings rate of the African Least Developed Countries (LDCs), after an increase from 6.6 percent in 1960 to 10.3 percent in 1970 declined to 4.0 percent in 1980 and was a mere 4.9 percent at the end of 1988. In the other countries, the savings ratios did not change significantly, declining from 19.0 percent in 1960 to 16.0 percent in 1970 and then slightly increasing to 17.4 percent in 1980 and to 18.7 percent in 1988. The crisis that was brought about by the great African drought and desertification and the deeping of the international economic recession during the mid-1980s may have caused such a stagnation or decline in the saving ratios in Africa, particularly in the African LDCs.

13. In North Africa and West Africa, where oil exporting countries like Algeria and Nigeria dwarf the other countries economically, a decline in the saving ratio was noted. Algeria, however, succeeded to sustain high saving ratio of about 35.5 percent of GDP through government controls over the oil revenues (main source of income). Excluding the four major African oil exporters, the saving rates oscillate at around 13.5 percent in the oil importing countries. The investment/savings gap as a percentage of GDP is shown in Table 2.

Table 2: Investment/Savings Gap as Percentage of GDP

Income Group	1960	1970	1975	1980	1985	1988
Major oil exporters	15.0	-5.4	18.2	13.0	2.5	2.0
Non-oil exporters	0.1	-2.9	0.4	1.8	0.5	1.7
Least Developed countries	0.0	3.0	4.7	7.6	13.5	18.3
Developing Africa	3.7	-1.8	7.1	6.6	5.5	5.5

Source: Ibid.

14. The average marginal propensity to save (MPS) for developing Africa as a whole also declined from 0.25 in the 1960s to 0.19 during the 1970s and 0.15 in 1980-1988. The non-oil-exporting countries in particular suffered a sharp decline in MPS from 0.30 between 1960-1970 to 0.06 between 1970 and 1980 and 0.05 in 1980-1988. The implications of the declining savings rates have been that the steady expansion of the domestic resource gap from 3.7 per cent of GDP in 1960 to 6.6 per cent in 1980 and 5.5 per cent in 1988. The largest expansions in the domestic resource gap were recorded in the African LDCs when both consumption and investment expanded simultaneously. This means that the majority of African countries have still continued to rely on considerable external borrowing and aid to finance their investment.

15. The deterioration of income since 1980 has affected savings in the trade-off between allocation of resources for consumption or of finance for capital formation. One of the serious problems that acts as an impediment on capital formation and development in Africa is the consumption patterns which tend to emulate those of advanced countries. This tendency does not make for saving and capital accumulation out of relatively low income. While the Keynesian contension that consumption expenditures are conducive to economic development and growth may largely be true for developed countries, the same could not be said to be true for developing African countries as there are limited and fairly inelastic production capacities. Thrift is their only option. Lack of unproximity of suitable financial and savings institutions force people particularly in the rural areas into hoardings or savings in kind, thereby limiting the size of actually financially mobilizable savings as compared to the potential.

16. An average gross domestic savings ratio of a little over 16 per cent recorded in developing Africa as a whole in 1980-1988 is very respectable by any standard, but is well below that of some other developing economies of Asia and Latin America in which gross domestic savings of a number of countries were appreciably in excess of 30 per cent of GDP throughout much of the 1970s and the 1980s. And in some of latter countries, the level of current income is similar or less than that of African countries. The level of income is but one of many variables impinging on the decision to save; GDP growth over time in another (Ratchet theories). 4/

IV. POLICY MEASURES FOR RESOURCE MOBILIZATIONS IN AFRICA

17. In a policy-making context, the investment requirements of a country that is determined to gain greater control over its own destiny has to be increasingly met from the savings of the three institutional sectors of the economy, namely the government sector, the household sector and the coorporate sector.

4/ See Duesenberry, J. S. Income, Saving and the Theory of Consumer Behavior (Cambridge, M.A. Harvard University Press 1949); M. Friedman A Theory of the Consumption Function (Princeton N.J.: Princeton University Press, 1957), and F. Modigliani and A.K. Ando, «Testes of the Life Cycle Hypothesis of Saving» Bulletin of the Oxford University Institute of Economic Statistics, 19, (1957), pp. 99-124.

4.1 Public Sector's Resources Mobilisation

18. As it was stated above, the primary responsibility for financing development programmes in Africa should be borne by the African governments themselves. The low levels of household income and the fact that large segments of African economies are non-monetarized, limit the size of actually mobilizable savings. A greater role in raising savings ratios has to fall on the public sector and the need for strengthening the public sector's savings effort should increasingly assume greater and wider significance. Policy measures to generate public sector's savings should be directed both on the revenue side and on the expenditure side.

Indirect Taxation

19. Of the various sources from which the necessary savings can be mobilized for public expenditure, taxes constitute the largest share of revenue in African countries. Tax revenue account for over 70 per cent of public revenue. Thus, raising revenues for government can be secured through increased taxation. This can be done through the introduction of new sources of taxes or the imposition of higher tariffs on luxuries.

20. Sales and excise taxes on such services as hotels, restaurants, transport, banking, insurance, construction and others which normally account for much of the value added created outside agriculture would need to be heavier. New taxes on petroleum, tobacco, alcohol, beer and luxuries in general should constitute additional sources of revenue. Other possible areas of additional taxation could result from a restructuring of import tariffs, of sales taxes and excise duties, rationalization of tax concessions to industry, of agricultural taxation, taxes on public services as well as improvements in tax administration and collection in general. Policy measures should also be directed toward reducing the excessive dependency of government revenue on foreign trade (import and export) which in most cases, fluctuate considerably, depending on the outcome of external environment.

Direct Taxation

21. Although some African countries have high marginal rates of tax on income and profits, these do not appear to result in high tax revenues because of evasion and the low tax base in general since most of tax revenues come from import and sales and excise taxes on a very limited range of consumer goods. Direct taxes on income and payroll contribute only marginally to the government revenues. Thus there is need to make the tax system simpler and more broadly based to tax not only household income but also business and property income and capital gains. In this respect, efforts have to be made to reduce tax leakages by streamlining the tax administration and by reinforcing customs departments with accountable people.

22. Forced savings charged on incomes in the form of education tax, health tax, rent tax, etc.; and elimination of subsidies on consumption except food items consumed by low-income groups are justifiable measures of economic policy for mobilizing domestic revenue. In order to make the effect of taxation on domestic resource mobilisation more prominent, tax rates should be structured in such a manner that they are highly progressive. Such taxes should be particularly heavy on unearned incomes such as wealth or property, capital gains, gifts, estates, inheritances, etc., to reduce not only consumption expenditure of high-income groups but also the degree of social inequality. Measures must be taken to convince the population of the necessity and inevitability of higher taxes on their incomes and sacrifices.

23. The tax structures prevailing in African countries are such that a disproportionately heavy burden of the tax falls on the rather small market sector of the economy as a result of which the volume of tax revenues continue to remain small. Indeed the majority of African countries, the tax ratio (as percentage of GDP) is less than 15 per cent as compared to other developing countries of Asia and Latin America for which the ratio is as high as 30 per cent. This indicates that there exists untapped tax potential in Africa and that additional revenues to finance development programmes can be generated through the introduction of new tax measures, for instance taxation of the agricultural surplus.

Non-Tax Revenue

24. The non-tax revenues derived mainly from earnings of public enterprises and revenue from government services should also be increased through such measures as increase in the fees and prices of the public sector goods and services, and the rationalisation or privatisation, where appropriate, of public and parastatal enterprises. The parastatals that are engaged in directly productive sectors should be given full autonomy to operate and generate profits like private enterprises and make them self-financing. Experiences in most African countries show that most public enterprises instead of making profits incur losses and have caused serious fiscal burdens to the government. In order to increase resources available to government, public enterprises must be reformed and their efficiency restored so that they generate rates of return that not only cover their recurrent costs, but also result in surpluses that can be mobilised with no fear of reduction in consumption expenditures.

Public Borrowing

25. Internal public borrowing from banks, business organisation and individuals or through the issuing of securities, bonds and certificates may serve as additional sources of finance that supplement revenues from taxes. Household savings, corporate and other forms of savings that may not be put to any productive use because of the lack of investment opportunities and returns could be tapped by means of public borrowing, although this will require the existence of developed capital and money markets to be an effective instrument.

Deficit Financing

26. The government deficit financing is another instrument for mobilising domestic resources if it is used more judiciously to finance directly productive ventures with short gestation periods. This method is resorted to as a residual source when revenues collected from different sources outlined above are still inadequate to finance expenditures and it involves one or more processes, such as borrowing or withdrawal of cash balances from central banks, the issuance of additional currency, etc. Funds raised through deficit financing should be spent only to mobilise idle or under-utilised resources, such as land, labour and minerals into effective use and should be used primarily for financing seasonal food and other agricultural production, the manufacturing of consumer goods like milk, sugar, drugs, book, etc. so as to increase supply and neutralise their inflationary potential. While deficit financing as a source of revenue should not be resorted to on a large scale and beyond a particular safe limit of say 3 to 10 per cent of GDP to avoid runaway inflation, it could and should be used moderately with effective price controls and with wages and salaries checked within reasonable limits.

Recurrent Expenditures

27. On the expenditure side efforts to increase revenue to finance development should be capped by a programme of austerity with efficient use and strict control of budgetary expenditure, particularly recurrent expenditure, to eliminate internal leakages in the form of wasteful expenditure. Therefore, government policy measures should endeavour to reducing operation costs, cutting back on current expenditures, streamlining enterprise management and identifying spending priorities whether for investment or consumption more efficiently. The purpose of these measures is to release more public savings for channelling into priority public productive investments. The administrative services should also be streamlined by introducing user participation in the cost of social services (particularly health services and education), by implementing measures to restrain non-essential public consumption and by limiting recurrent budget expenditures (for example reduction in defence spending during the period of peace).

28. In addition to the measures taken to make parastatals self-financing, efforts should be made to limit their recurrent expenditures. This require their efficient management by recruiting competent, dependable and conscious administrators. Subsidies should only be provided in a selective manner, namely to such sectors as health, education, selected agricultural items like fertilizers, equipment extension services, productive small-scale industries and the rehabilitation of existing structures in the assumption that these transfer costs will be recouped from the increased revenue from the taxation of farm produce, the increased productivity of the labour force and the overall higher growth and transformation of the economy.

4.2 Mobilisation of Household Savings

29. The extremely low level of per capita income in the majority of African countries with the bulk of the population far below minimum standards of living and in subsistence sectors is the principal reason for low household savings in Africa. Forced savings charged on incomes in the form of education tax, health tax and state pension schemes into which household wage and salary earners may pay a portion of their incomes with matching contributions by employers could be considered as inevitable measures for resource mobilisation. Attention may be drawn to the need for formulating appropriate incomes and pricing policies for the generation of additional revenues for development. Among these policies should feature the need for narrowing salary and wage differentials between country and town. For example in some African countries the ratio of public sector wages to the income of a peasant runs 20:1.

30. Experiences show that even the poor can save. The saving potential of the household sector is less than fully exploited and the development of financial institutions particularly in the rural areas and the insurance of their accountability can help in bringing about a higher saving rate and a better utilisation of the existing flow of savings. There is urgent need to tap potential savings at all levels of society. The hidden and often hoarded reserves of poor rural communities can be tapped through the expansion of rural banking, mobile banks, post office savings, encouragement of local thrift and cooperative societies, rural saving campaign, etc. The discouragement of conspicuous consumption through taxation (e.g. entertainment tax) and other measures should also dovert resources from consumption to savings. Job creation that raises household income levels will also increase the capacity to save.

4.3 Mobilisation of Corporate Savings

31. Although the size of indigenous private corporate sector in Africa is still small, profits generated by these productive private enterprises, both national and foreign, constitute important sources for the mobilisation of domestic resources. Where private enterprises are efficient enough to generate profits and when these profits are used for creating additional productive capacities, further mobilisation of domestic resources takes place. This argument extends to most economic activities including foreign and domestic trade. Profits from such activities are potential sources of domestic resource mobilisation.

32. Obviously, this source and method of resource mobilisation has greater significance in countries that have brought industry, trade and other economic activities under public control and have helped increase the low capacity utilization that is recorded everywhere in Africa, and which, in turn, results from the small size of market, inedaquate supply of raw materials and spare parts as well as deficiencies in managerial capability. Foreign transnational corporations should be asked either to reinvest directly their profits or to lend their surpluses to the public, household or other corporate enterprises in the country for channelling to productive investments opportunities.

4.4 Human Resource Mobilisation

33. Another broad area of priority attention for bringing human resources into actively productive use is the vast pool of under-employed and unemployed labour. A number of African countries are rich in natural and human resources. The resources of unutilized arable land, estimated at over 90 per cent, as well as of labour, can only be considered as vast reservoirs determining the mobilisation of resources. The exploitation of natural and human resources provide the real premises of a country's social and economic development. These real resources can be mobilized on a large scale to satisfy infrastructural

needs such as roads, water works and bridges and services such as schools, clinics, housing and related services. Efforts must be made by African countries to mobilize unproductive and underutilized labour in rural and urban areas (the example of Rwanda, UMUGANDA, and Ethiopia is a start in this direction). Co-operative self-help and self-financing schemes should be promoted and credit facilities should be made available to supplement and encourage such efforts.

34. Substantial savings, both in cash and in kind, concealed in rural labour can thus be utilized to finance the recurrent and capital costs of development projects and programmes. The army and, during vacation times, students should be mobilized to supplement rural labour for the construction of the much needed social and physical infrastructures (schools, hospitals, bridges, feeder roads, etc.) To drive full advantage from these resources, communities must be convinced that development projects and programmes are in their best interests and are made to respond to their needs and conditions.

4.5 Financial Leakages

35. The decline in the domestic savings ratio during the 1980s and the resulting widening of the saving gap have further exacerbated by the decline in the foreign exchange availability which was caused by the decline in demand for and dramatic fall in the prices of commodities exported by the African countries. Further resource constraints were imposed by the growing size of resource outflow arising from real and financial leakage and debt services at the same time that the resource inflows in real terms have stagnated or fallen. The real and financial leakages arose principally from numerous sources, notably those arising from: international trade transactions such as over-invoicing of imports and under-invoicing of exports; service payments such as insurance, tourism, investment income; and capital flight. The over-invoicing of imports and the under-invoicing of exports are particularly important sources of illegal appropriation of foreign exchange and its retention abroad.

36. More seriously is import over-invoicing where the various stages of processing and industrial classification allow more maneuverability. Multi-national oligopolies in particular take advantage of their vertical integration and as such benefit through the usual practice of transfer pricing and avoid taxation through intra-firm transactions. Another important source of financial leakages arises from the weaknesses in the domestic services sectors in the form of payments for services like shipping, insurance, etc. This together with such items as foreign travel and tourism drain the African economy out of critically needed resources and as such aggravate the balance of

payments position. 5/

37. A "capital flight" has become a serious problem of the mobilization of financial resources. Although no firm estimates are as yet available for the African region, there is general evidence to suggest that illegal outflows are large and growing rapidly. 6/

38. Therefore, radical measures should be taken to minimize the volume of external financial leakages arising from illegal over-invoicing of imports and under-invoicing of exports which result in the outflow of substantial resources from African countries. African governments should vigoriously pursuit the policies for restructuring their economies such that greater dependence is placed on the domestic sector through the maximum use of domestic resources and potential in meeting local needs. Closely related to this is the need to stamp out corruption, indiscipline and inefficiency in the public sector. Where restrictive procedures on exchange control, imports, etc. have to be adopted, these should be properly streamlined so that loopholes are minimized. Monetary reforms,confidence in the capacity to maintain the exchange rate, the insurance of safety of capital, the economic stability, the liberalization of national banks so that they can offer financial services with competitive risks and returns, etc. might bring about a reversal of capital flight and facilitate capital repatriation. Likewise, given the mobility of factors, human capital would not migrate if it receives a competitive market wage and job security. Thus, "capital flight" and "brain-drain" ought to be viewed as a sympotom of underlying economic problems of underdevelopment rather than as the source of the problems.

5/ In an ECA study entitled: "Financial leakages in Africa" (SERPD/WLAE/83/2), Addis Abeba December 1982, it has been estimated that in 1979, financial leakages due to illegal activities in official merchandise trade alone amounted to US$5.5.billion i.e., US$3.6 billion on imports plus US$2.9 billion on exports or 4.2 per cent of the total value of trade marchandises. Further invisible costs to African countries were over US$5.0 billion for shipping, nearly US$2.0 billion for insurance and unremitted package tour receipts were over US$1.0 billion. The overall financial leakages amounted to about 30 per cent of foreign aids in 1979.

6/ Several studies on this subject reveal that private capital outflow from developing countries in general runs from $50 billion to $200 billion or higher over the past ten years. For individual developing country, the estimates range from $10 to 20 billion or more depending on the definition of capital flight adopted. This occurs particularly in the highly indebted countries of Latin America, i.e. Argentine (capital flight stock was $30.6 billion in 1984), Brazil ($10.6 billion), Mexico ($40.1 billion), Venezuela ($25.9 billion), etc. Taking the World Bank definition of capital flight (=change in debt + net foreign reserves), the domestic capital outflow from Africa as a whole can be put at $38.6 billion in 1986 and $20.2 billion in 1987. Estimates of this magnitude support the view that if capital outflows from developing countries were to be reduced or reversed, the adjustment to the debt burdens of these countries could be eased and domestic resources for investment would be increased substantially. For more detailed analysis, see Robert Cumby and Richard Levich, "On the Definition and Magnitude of Recent Capital Flight" in D.R. Lessard and J. Williamson (ed.) Capital Flight and Third World Debt, (Washington D.C.: Institute for International Economics, 1987), pp. 27-78.

4.6 Efficient Resources Allocation

39. Once the resources have been mobilised they need to be allocated into proper development channels which can generate rates of returns that not only cover their recurrent costs, but also result in surpluses which can then be mobilised for further investment opportunities. The proper management of the limited human, physical and financial resources has been the major argument behind the use of the competent machinery for efficient resources allocation, be it market mechanism or centrally planned mechanism. The analysis of investment allocations indicates that in the majority of the African countries until recently a disproportionately large portion went for purposes which are not directly productive (services sectors mainly) and that a relatively small proportion was allocated to the productive sectors (agriculture, industry and construction).

40. It hardly needs stressing that with scarce resources and pressing needs, it is essential that a rational and systematic approach should be used in resource allocation. A critical element in this regard is project preparation and appraisal covering the full range of financial, economic, technical and organisational conditions necessary to achieve the objective of efficient resources allocation. To ensure the efficient use of scarce resources, the use of economic prices in cost-benefit analysis would be desirable. All projects and programmes should be subjected to vigorous analysis of their costs and benefits to the country and such analysis should indicate financial and economic internal rates of return which are the basic criteria for project selection and appraisal. African governments would thus need to build up and strengthen national capabilities to conduct such project studies and analysis.

V. FEASIBILITY OF ACHIEVING 25-30 PER CENT SAVINGS RATIOS IN THE 1990s

41. The increase in savings through the full implementation of the above policy measures for resource mobilisation is based on the assumption that the African countries will endeavour to achieve the medium and long-term objectives stated in the Lagos Plan of Action (LPA) and the Final Act of Lagos (FAL), which include inter-alia the alleviation of mass poverty and improvement in the standard of living of African people, the adoption of the strategy for self-reliant and self-sustained development, the necessity to increase the output of the productive sectors (namely food and agricultural and industrial output), the desirablity of attaining substantial increase, if not doubling of, per capita income by the year 2000, the expansion of intra-African trade and cooperation, and the establishment of mutually beneficial and equitable relations between African countries and the rest of the world. The doubling of per capita income by the year 2000 implies that GDP at constant prices should grow at least twice as high as the rate of growth of the population.

42. This requires a growth rate in GDP of 7 percent per annum for Africa as a whole during the period 1990-2000. This growth rate was obtained from the extrapolation of the GDP simulated for the various income subgroups of African countries, namely the least developed countries which were projected to grow by 5.9 per cent yearly, the non-least developed countries projected to grow by 6.5 and the major exporting countries by 8 per cent yearly.7/. In addition, to attain this 7 per cent growth target, major efforts would be required to expand the major productive sectors: agriculture would have to increase by at least 4 per cent per annum during 1990-2000, manufacturing would have to expand at 9.5 per cent yearly and mining by about 5.8 per cent per annum 8/.

43. The target growth of real GDP envisaged for Africa as a whole would have to be accompanied by a growth of 7.8 per cent yearly in investments and this will raise the investment share in GDP to 30.8 per cent by 2000 as compared with the average of 17.3 per cent during 1965-1986. Also such an increase is expected to be accompanied by a significant increase in the efficiency of capital; that is, the overall incremental capital-output ratio (ICOR) would be maintained at around 4.4:1 in the 1990s as against the average ICOR of 5.0:1 in the 1980s. To realize this investment, domestic saving would have to be increased and a high saving rate of at least 23.1 per cent would have to be achieved by the year 2000 as compared to the average of 17.3 per cent obtained in the period 1965-1986. This savings rate hides, however, the reality of disparities among income groups; the efforts required to increase savings by each income group of the African countries are shown on Table 3 below.

7/ See Table 3.

8/ The 7 per cent average annual growth in GDP for developing Africa as a whole would also entail relatively high expansion in the infrastructural sectors namely construction, energy and transport which were projected to have to grow by 9 per cent, 8 per cent, 9.8 per cent respectively and services are projected to increase at an average annual rate of about 7.6 per cent over the entire 1990-2000 period.

Table 3: Required Savings Efforts in the Planned Scenarios

Group of countries	Periods (a)	GDP growth rate per cent (b)	Investment		Saving Rate as % of GDP	Import as % of GDP	Export as % of GDP	Saving gap as % of GDP	Trade gap as % of GDP
			Growth rate %	Rate as % of GDP					
Least Developed Countries(c)	1985-88	3.5	4.7	13.9	4.7	22.1	17.4	9.2	4.7
	1990	3.6	4.7	13.7	10.5	22.5	16.9	3.2	5.6
	1995	5.9	6.9	14.1	11.01	23.2	17.5	3.1	5.7
	2000	5.9	6.9	14.4	11.2	23.7	17.9	3.2	5.8
Other Developing Countries(d)	1985-88	2.7	5.0	14.6	18.9	28.9	33.5	4.3	4.6
	1990	4.0	5.3	21.0	20.5	28.9	35.1	0.5	6.2
	1995	6.3	9.6	25.3	22.5	36.0	33.7	2.8	2.3
	2000	6.4	8.9	28.7	28.0	41.4	31.7	0.7	9.7
Major Oil Exporting Countries(e)	1985-88	-0.3	7.5	20.5	28.4	44.8	17.1	-7.8	27.7
	1990	2.5	7.0	43.3	26.5	47.4	21.4	16.8	26.0
	1995	7.7	5.5	41.3	28.0	48.0	24.3	13.3	23.7
	2000	8.1	6.5	38.7	30.0	47.7	27.1	20.4	20.6
Developing Africa as a whole(f)	1985-83	2.0	5.7	17.3	17.3	32.5	21.5	0.0	11.0
	1990	4.5	5.0	26.4	17.4	35.0	22.5	11.0	12.5
	1995	6.8	7.9	30.0	20.5	37.8	23.6	9.5	14.2
	2000	7.0	7.5	30.8	23.1	39.6	24.8	7.7	14.8

Source: ECA Secretariat provisional estimates and projections

(a) The growth rates concern the periods 1988-1990, 1990-1995, and 1995-2000;

(b) At constant 1980 market prices;

(c) The African least developed countries in the sample include Botswana, Benin, Burundi, Burkina-Faso, Cape Verde, Central African Republic, the Comoros, Chad, Ethiopia, Gambia, Guinea, Guinea-Bissau, Equatorial Guinea, Lesotho, Malawi, Mali, Rwanda, Sao Tome and Principe, Somalia, Sudan, the United Republic of Tanzania, Uganda, Sierra Leone, Togo;

(d) The Non-least developed countries include Angola, Congo, Egypt, the Ivory Coast, Ghana, Djibouti, Liberia, Kenya, Madagascar, Mauritius, Mozambique, Senegal, Seychelles, Swaziland, Zimbabwe, Zaïre, Zambia, The United Republic of Cameroon;

(e) The major oil-exporting countries are Algeria, Gabon, The Libyan Arab Jamahiriya and Nigeria;

(f) Developing Africa = c + d + e.

44. Another very important consideration concerns the projection of the LDC's saving and investment rates which are far below the regional average level. It was believed that it would be unrealistic, given the large consumption needs of these countries, to assume a drastic increase in the level of domestic savings whose share on GDP was projected to hump from 4.5 per cent in 1985-1988 to around 11 per cent in the 1990s. This imply that the LDCs have to make tremendous efforts, if not major sacrifices, to increase domestic savings at the average annual rate of 6 per cent during the 1990s to be close to the projected investment growth rate of 6.9 per cent. This also assumes that there is an improvement in the incremental capital output ratio in these countries from 3.1 in the base year to about 3.1 in the 1990s, otherwise, the resource gap would widen substantially and much higher inflows of external assistance would be necessary.

45. For the other developing countries - non major oil exporters - the planned scenario assumes that, unlike in the past, domestic savings would be used in the future to increase investment substantially and that the share of investment will rise from 14.6 per cent to 25.7 per cent in the year 2000, which will be almost financed by domestic resources, leaving only a small resource gap of 0.7 per cent of GDP. Since some of the countries in this group have already some industrial base, exports, particularly of manufactured goods, could be pushed up and these countries could strive towards a certain type of self-sustained growth.

46. Finally, the scenario assumes that the major oil-exporting countries would increase their exports in real terms at growth rate of 10 per cent and the ICOR will decrease from 5.7:1 in 1985-1988 to 4.9:1 in the 1990s so that the substantially high level of investment recorded in the late 1970s and early 1980s which overheated their economies will be reduced and serious efforts will be made to increase savings rate to reach about 30 per cent of GDP by 2000, leaving a resource gap of 3.7 per cent. It is also assumed that their import elasticity will be reduced to 1 by 2000 as, compared to the historical average elasticity of 2.4 in the 1970s and 1980s, particularly imports of goods.

47. At the projected investment rate of about 30.8 per cent of GDP in 2000, the projected saving rate would still leave a relatively high gap of about 5 per cent of GDP for Africa as a whole which implies that an even higher saving rate of over 25 per cent of GDP should be aimed at through full implementation of policy measures outlined previously. An improvement in the efficiency of capital is of great importance, especially for these countries like LDCs which still have a lot of consumption needs and cannot in the short-run reduce their consumption rates drastically. Yet it was found that the trade gap would be the dominant gap and hence increased savings would have to be accompanied by appropriate policies so as to avoid the frustration of domestic savings.

Table 4 : Projected Feasible Savings as a Percentage of GDP

Group of Countries	1990-1995		1995-2000	
	Historical Trend Scenario	Planned feasible Scenario	Historical Trend Scenario	Planned feasible Scenario
Least Developed Countries	4.5	11.5	5.0	11.2
Non-Least Developed Countries	18.0	22.5	21.0	26.0
Major Oil-Exporting Countries	20.0	28.0	24.0	30.0
Developing Africa as a whole	14.2	20.5	16.7	23.1

Source: ECA Secretariat provisional estimates.

VI. CONCLUSIONS

48. The substantial structural change of the African economies has not been achieved in the past because of (a) the failure to mobilize domestic resources for development, (b) the critical and continuous dependence of structural transformation on external factors, and (c) the occurence of deep seated crisis (drought and desertification) beyond Africa's control. These factors among others diverted development from its tune path. Thus, it seems that a successful and genuine economic and social self-sustainment and structural transformation in Africa to be realizable in the 1990s would depend on the expeditous mobilization of domestic resources and their efficient allocation so as to achieve an increasing degree of internalisation of the factors of production (including technology) and financial autonomy as well as viability.

49. The envisaged increase in domestic resources to attain the maximum growth of 7 per cent per annum for Africa as a whole as stated in the LPA requires tremendous efforts and sacrifices on the part of the African Governments, and people and the creation of an enabling environment. It is of paramount importance, that the conditions and instruments for the mobilization of additional resources from voluntary private saving (households, small business and communities) should be created, with particular emphasis given to the large agricultural subsistence sector. The development of financial institutions in the form, inter-alia, of savings banks, co-operative societies, commercial banks, pension offices and insurance companies should help in bringing about both a higher saving rate and a better utilization of the flow of resources.

50. As was projected in this paper, the achievement of a 7 per cent growth of GDP yearly during the 1990s would require an investment rate of about 30.8 per cent if the ICOR is maintained at 4.4:1. But in view of the fact that more than half of the African countries are in the LDC category, the projected increase in the domestic resources mobilization can only reach about 23.1 per cent of GDP by the year 2000 for Africa as a whole as compared to 17.3 per cent in the 1985-1988 period. But if a successful savings mobilization programme is initiated by the government along with the lines of the policy mix suggested in this paper which has to be especially directed towards the optimization of the public sector, household and corporat savings and more efficient allocation to productive investment, a saving rate of 25 per cent or more can be feasible for the 1990s. This will reduce the saving gap to the manageable level of less than 5 per cent, to be financed by external aid. As there are no general hard-and-fast rules for optimum saving mobilization, each country constitutes a special case requiring individual policy instruments.

VI. CONCLUSIONS

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PARRALLEL FOREIGN EXCHANGE MARKET AND INTRA-REGIONAL TRADE COOPERATION

I. INTRODUCTION

1. The Lagos Plan of Action and Final Act pay particular attention to intra-regional trade cooperation by providing for 1/ the implementation of a very complete programme of long-term economic cooperation mechanisms among African countries with a view to meeting their needs in the areas of trade, production of foodstuffs, minerals, manufactured goods, improvement of the means of transport and communication, etc. The success of this programme should lead to an intra-regional trade cooperation policy.

2. Nonetheless, the implementation of this programme is still confronted with some difficulties among which an inadequate control of economic power 2/ and especially by the existence of a system of payments and renumeration of factors inherited from the functioning of the international monetary and financial system. Another obstacle to the emergence of an optimal trade-cooperation situation is the existence of parallel foreign exchange markets which undoubtedly result from permanent foreign exchange crises and the accompanying lack of supplies. These crises somehow compel monetary and financial authorities to require prior authorization for all foreign exchange transactions.

3. But, this control usually does not have any impact in a period of extreme shortage and inflation which characterize African economies. On the contrary, it worsens the problems caused by the overvaluation of the official exchange rate and favours the disintegration of market mechanisms 3/.

4. The disintegrated mechanisms will give rise to a parallel foreign exchange market with its perverse impact on intra-regional trade cooperation. That is the content of this paper of which the main points are the following:

1/ See ECA, The Role of Commercial Banks in the Development of Trade among Central African Countries, Doc. E/ECA/TRADE/1 para. 1.

2/ See Mike Faber and R. Herbold Green, «Le malaise économique de l'Afrique subsaharienne», dans OCDE, Afrique subsaharienne de la crise au développement, Seminars of the Development Centre, OECD, 1985, p. 16-30.

3/ See Pierre DUPRIEZ, Contrôle des changes et structure économique, Paris: Mouton et IRES, p. 33-52 World Bank, Report on World Development, 1987, ch. 7, p. 131-152.

I. Definition of the parallel market

II. The causes of the parallel market

III. The economic impact of the parallel foreign exchange market

IV. Parallel foreign exchange market and intra-regional trade cooperation

V. Measures for controlling the parallel market

VI. Conclusions and recommendations.

II. DEFINITION OF THE PARALLEL FOREIGN EXCHANGE MARKET

5. The parallel foreign exchange market is a clandestine market on which foreign exchange transactions 4/ are carried out by violating the law. This market rises from the failure to meet the demand for foreign exchange on the official market where it is limited by the rules of exchange control. Such a market does not need a precise geographical setting; while it is forbidden in principle within the country, it is practically free beyond the borders. Well organized, the parallel market is impervious to any administrative control. It can operate through simple private clearing and part of the accounts are kept outside the country while the other part can be easily hidden under trade and real estate transactions.

6. It is thus a market that exchange control and the lack of foreign exchange turn necessarily into a buyer's market. As a result, the exchange rate on this market is higher than the official exchange rate.

III. THE CAUSES OF THE PARALLEL FOREIGN EXCHANGE MARKET

7. The main cause of the parallel foreign exchange market is the transfer to foreign exchange of the normal functions of the national currency, that is the functions of trade intermediary, unit of account and reserve of value.

8. When an exchange control regime is established, the bank authority imposes restrictions on imports. These restrictions are in the form of rationing or quotas which limit the volume of authorized imports in order to reduce foreign exchange expenditure. By limiting imports, exchange control will already bring about excess demand compared to supply 5/.

4/ Some economic agents often classify the most diverse measures and the most varied regimes under the term parallel market. When, one talks about the free market, the black market, smuggling but all these terms are not always identical even though the facts they imply are interdependent.

5/ P. Fontigny, "Note sur quelques effets des contingentements et des taxes d'importations" in Bulletin de l'IRES, Louvain, vol. VII, 3 May 1936, p. 367-399.

9. If demand can only be met by imports, exchange control will have a direct impact on supply and, through rationing, it will limit the quantity of goods supplied to the market. The existence of some supply rigidities will lead to new excess demand which will be reflected, on the black market, by a rise in prices higher that the one which would exist on a perfectly fluid market. Permanent excess demand will be met by imports of goods financed by purchasing foreign exchange on the parellel market.

10. The national currency gradually ceases to fulfill its trade intermediary and unit of account function. In fact, it does no longer allow one to buy any good and numerous goods can be bought only with foreign exchange. Thus, more than the national currency, foreign exchange is demanded to satisfy that motive for transaction which Keynes 6/ defined as «the need for liquidity» for the current realization of personal exchanges and trade. Since the national currency only imperfectly fulfills its trade intermediary role, the money function tends to shift from the national currency to foreign exchange.

IV. THE ECONOMIC IMPACT OF THE PARALLEL FOREIGN EXCHANGE MARKET

11. Henceforth, it becomes logical to use as money the instrument which serves as trade intermediary. This is encouraged by the uncertainty which surrounds the issuing of licences for imports which are necessary for amortizations or simply for the normal functioning of the firm. Any economic calculation in the national currency becomes extremely uncertain 7/. Entrepreneurs and businessmen begin to evaluate their activities by referring to the foreign exchange value of the goods which they supply to the market.

12. With the appearance on the market of a parallel exchange rate for foreign currencies, the national currency loses its value reserve function. The motive for cautiousness as the motives for speculation and transaction increase foreign exchange demands. Holding part of cash abroad protects the owner against the future deterioration of the national currency and allows the speculators to profit from the appreciation of foreign exchange 8/.

13. These three motives (caution, speculation and transaction) will transform the demand for money into a demand for foreign exchange which cannot be entirely met by the official market which is limited by exchange restrictions.

6/ J.M. Keynes, The General Theory of Employment, Interest and Money, London, 1957.

7/ H. Leclercq, «Analyse générale de l'inflation congolaise», Cahiers économiques et sociaux, I, 1st October 1962, p.25.

8/ See André Page, Monnaie, répartitions et relations internationales, Paris Daloz, 5e édition, 1986, p. 163.

14. This schematic reasoning allows us to say that resort to the parallel market starts off a cumulative process. 9/ In fact, the national currency on which speculators' pressures are exerted, will fall off its parity because of intense pressures by foreign exchange buyers. And, at the same time, foreign exchange will appreciate and widen the gap between the official parity and the parallel market exchange rate. The gap between the two rates will reinforce inflationary pressures. As a result, prices and the profits made by middlemen and importers will rise. Trade profits will increase further the demand for foreign exchange, and monetary income from the sale of foreign exchange on the parellel market will, in turn, hike the demand for goods and services.

15. Once the cumulative process is started off, there is no one single parallel market but there emerges a whole parallel economy which will live as a parasite on the legal economy. Informal economic and trade relations will supersede the official networks. Clandestine activities and operations aiming at making profits out of the shortage of supplies, will grow faster than the official trade and intra-regional trade cooperation will be affected by these developments.

V. THE IMPACT OF THE PARALLEL FOREIGN EXCHANGE MARKET ON INTRA-REGIONAL TRADE COOPERATION

16. The main difficulty in intra-regional trade cooperation in Africa is by far fixing prices and determining appropriate exchange rates for numerous national currencies. 10/ In a country where the parallel foreign exchange market is prosperous, these difficulties are exacerbated further by the fluctuation of the prices of imported goods and, in particular, of current consumer goods and luxury goods. The situation is even more delicate for primary commodities of which the prices are difficult to fix in advance for a long period with some chances that the two trading parties would be finally satisfied by the result. It is the resentment caused by the gap between the prices expected and the prices effectively paid which will serve as a catalyst of the parallel market operations and perturb seriously enough the trade relations between the contracting parties.

17. In a normal situation, intra-regional trade cooperation relations aim at correcting this resentment by increasing official trade 11/ financed by a clearing system which uses the currencies of the member countries. The

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9/ P. Dupriex, op.cit., p.100.

10/ Among other difficulties, we may cite the role of transnational corporations, the lack of trade information, customs duties and other restrictions, insufficient financing, etc. See ECA, Development and Expansion of Intra-African Trade, E/ECA/TRADE/85. See also ECA, The Establishemnt of an African Monetary Fund: Structures and Mechanisms, technical feasibility study, para 15.

11/ See the proceedings of the 2nd colloquium on the economic integration of West Africa, Conakry, 1980, p. 243.

realization of this objective requires the harmonization of trade policies as well as the coordination of the customs, monetary and fiscal policies of the contracting countries. 12/

18. But, resort to the parallel market breeds a feeling of defiance towards the national currency, which is fuelled by the most diverse sources such as the position of external payments, a confused internal financial situation, an uncertain political climate, the alleged designs of the governments, etc. 13/ This climate will be maintained by the economic agents who want to accumulate capital in foreign exchange abroad.

19. The behaviour of these economic agents will maintain speculative operations through capital flight for security reasons or by anticipating profit based on the depreciation of the national currency. 14/ For these feelings to be satisfied, economic agents will set mechanisms for going around the law and official regulations governing trade in goods and services. 15/

20. Arrangements will be violated by fraudulent practices favouring and financing smuggling, illicit imports, misappropriation of transit trade, non repatriation of export earnings. These illegal transactions which are not recorded, will have a great negative economic impact on the countries in which they are carried out and will therefore gravely disturb trade cooperation relations.

(a) Smuggled goods

21. With the parallel market, the smuggling of goods develops and is carried out on the basis of a tacit agreement between suppliers and buyers on both sides of the borders of neighbouring countries on the types and quantities of goods and the modes of payment. The means of payment are not related to the official exchange rates.

12/ See also ECA, Bilateral Trade and Payments Agreements Concluded in Africa, Doc E/CN.14/STC/24/Rev.1

13/ Andre Page, op.cit., p. 462

14/ For P. Dupriez, op.cit. p.99 "The national currency is now only very imperfectly choice power because its holder does no longer have the full freedom to choose the good that he wants to buy. Besides, the three motives for transaction, caution and speculation argue for foreign exchange cash holdings and the convergence of these motives is enough to transform partially demand for foreign exchange".

15/ Practically all the bilateral agreements always include a clause which stipulates that "the two contracting parties must support and facilitate between themselves and within the limits their laws and regulations the widest trade in goods in accordance with the examples contained in the list appended to the agreement or relating to other items which are not explicitly mentioned". (E/CN.14/STC/24/Rev. 1 para 11).

22. The goods which are smuggled, are generally imported goods but they may also be livestock 16/ or local products. These transactions often lead to a substantial loss of ressources for the countries concerned and deny them an important source of foreign exchange 17/, distort clearing relations and cause the treasury to lose tax receipts. This is due especially to falsifications of documents and false declarations.

(b) Falsification of documents

23. The products financed by the parallel market have the characteristic of being accompanied by false documents. These practices take two forms falsification of documents and creation of false documents. Falsification implies the presentation of false information relating to quality, value, type and quantity of exported and imported goods. Falsification may be done by deliberately through deliberate alterations of figures, omissions and calculation errors in official trade documents such as invoices, customs declarations, bills of leading and insurance documents.

24. Fabrication of false documents is a more serious practice in so far as it is very well organized and cannot therefore be detected easily. In a parallel market, a fabricated document inevitably leads to distortion of information relating to goods and generally favours theft and smuggling of imported consumer goods such as television sets, radios and other electronic equipment, spare parts and other which are paid for in foreign exchange and sold in local currencies in neighbouring countries.

(c) Misappropriation of transit trade

25. It appears from practices that the parallel market by favouring smuggling, also misappropriates transit trade. Then, trafficked products are brought into a country not to be consumed but to be transferred and reexported fraudulently to other countries in order to earn foreign exchange. 18/

(d) Loss of earnings

26. Import and export taxes are quite obviously not paid on smuggled goods, which constitutes a loss of earnings for the countries concerned. Given that most of the African countries earn a good portion of their income from customs receipts and indirect taxes, large-scale smuggling to or from one country may have serious consequences on public finance. For most countries, the loss of earnings is a serious problem which has serious repercussions on their efficiency in economic management.

16/ ECA, Unrecorded Border Trade among African Countries, Preliminary note by the Secretariat, Doc. E/ECA/TRADE/80, para 10. ECA, Ibid, para 15.

17/ In some border areas transactions are carried out in foreign currency, notably in dollars or in pound sterling. The evaluation of duties is not based on any official document.

18/ ECA, E/ECA/TRADE/80, para 15. "Precise examples are notably used clothes from Rwanda sold in the border areas with Uganda and Kenya and gold smuggled from Zaire is sold on far-away markets, notably in the Middle East. Coffee is another commodity which is smuggled into one country and reexported abroad to earn foreign exchange.

(e) Foreign exchange flight

27. The flight of resources from an exporting country is another important aspect of the parallel market. It takes place when a considerable portion of basic commodities is smuggled abroad because of the price differential with neighbouring countries. The loss suffered by the country is therefore calculated not only in terms of earnings but also in terms of foreign exchange because the smuggled commodities are generally paid for in local currencies. Some countries also suffer losses of foreign exchange on the goods smuggled out of their territories because the goods which are smuggled out, were initially imported and paid for by them in foreign exchange through the official channels.

VI. MEASURES FOR CONTROLLING THE PARALLEL MARKET

28. All the measures which may be proposed to resolve the parallel market problem have to include a sound management of exchange and prices policies.

29. The fact that some currencies are exchanged up to ten times less than their official rates reflects a serious imbalance in their purchasing power compared to the currencies of the neighbouring countries. If in country A a product is sold at the equivalent of ten dollars and if the same product is sold at the equivalent of one dollar in country B, we are in a situationof overvaluation of the curency of country A. In the case of the parallel market, this situation will lead to an exchange rate reflecting a de facto devaluation of the currency of country B which will have only one tenth of its value. This example is not necessarily a typical case but in numberous situations, some national currencies may depreciate by 200 to 300%, which requires for the currencies concerned an appropriate adjustment in order to arrive at a realistic exchange rate whish would no longer encourage traders to smuggle goods.

30. Price fixing policies which create large disparties with the prices in force in neighbouring countries constitute a great incentive to the parallel market. It is worth noting that in some areas, price differentials are an important cause of the smuggling of commodities such as coffee and cocoa as well as foodstuffs such as maize, millet, sorghum, cassava and others. The price fixing policy should generally take into account other factors such as the streamlining of the collection and distribution of food crops within the country, the strengthening of the efficiency of marketing and cooperative bodies, the improvement of transport systems and speeding up the payment of producers. Improvements in these areas would contribute to reducing considerably the volume of smuggling and, therefore, its source, the parallel market and vice versa.

(a) De facto legalisation of border trade

31. There is, in numerous border areas, a de facto situation in which border populations of both countries trade with each other with the tacit agreement of the governments concerned. The populations are authorized to cross the border and to buy small quantities of commodities which are imported duty-free. This trade, however, is not recorded. Some countries create official trading posts where products are sold to the population of the neighbouring country and paid for in local currency at the official exchange rate.

(b) Harmonization of tariffs

32. The adjustment of tariffs is an important way of resolving the problem of illegal trade. Some countries charge high customs duties on some categories of products, in particular the so-called luxury items such as electronic appliances, alcoholic beverages, jewellery, perfume, etc. in order to discourage their importation so as to save the scarce foreign exchange of these countries. Other consumer goods are also subject to high taxes in order to protect the local industries. These products are smuggled in order to avoid paying these high customs duties as well as to go around red tape and the need to obtain a certificate from the monetary authorities. Agreements on the reduction and harmonization of the tariffs of neighbouring countries where wide-scale smuggling of these products exists, may reduce this activity, promote normal trade and cut down the activities of the parallel market.

(c) Production and supply of essential goods

33. The shortage on the local market of consumer goods and essential goods is another reason for illegal trade. It has been contended that the smuggling of these products allows in this case to meet a persistent demand which cannot be met through official channels. The authorities could fight against the smuggling of these products by adopting appropriate policies with a view to increasing production and insuring regular and continued supply.

VII. CONCLUSIONS AND RECOMMENDATIONS

34. As it appears from this analysis, the parallel market is manysided and may involve all the types of products, goods and services. The reasons for this market have been examined even though not all the ramifications of the problem have been analyzed.

35. It has been shown that the existence of the parallel market is harmful to intra-regional trade cooperation by praising smuggling and financing illegal trade.

36. While the base of trade cooperation is the expansion and diversification of countertrade, the parallel market owes its success to shortage, fraud and falsification.

37. The parallel market widens the gaps in the trade and bilateral payment balances, destabilizes markets and prices.

38. Since the loss of earnings, the flight of foreign exchange and the economic distortions that the trafficking of foreign exchange causes on the parallel market, have interdependent causes and consequences, they undoubtedly affect the good-neighbourliness and trade cooperation among States.

39. The main issues to be resolved are therefore adequate supply of markets in general consumer goods and in essential products, appropriate investments in production sectors, the establishment of realistic exchange rates, the

elimination of enormous price differentials, reforms of inefficient fiscal policies and of trade and customs procedures, adoption of an appropriate exchange regulation as well as realistic import and pricing policies. Monetary and fiscal measures are also necessary for making adjustments in the economy in order to fight inflation and the problems of the parity of the national currency with those of neighbouring countries in order to maintain real purchasing power. As it was underlined, currency overvaluation is one of the main causes of currency trafficking and smuggling.

40. Taking into account these factors, it would be worth recommending that at the national, sub-regional and regional levels, the following policies be examined:

(i) Streamlining the activities of the existing economic groupings by ensuring specialization in defined sectors and providing for regular consultations in order to implement all the clauses of the treaties of sub-regional groupings and, in particular, giving a high priority rank to the creation of multinational production and marketing corporations.

(ii) Establishing long-term purchasing and supply agreements on foodstuffs and primary materials and developing countertrade in order to reduce to the minimum expenditure of convertible currencies; undertaking, on a priority basis, joint research on the supply of and demand for products in each sub region in Africa with a view to adopting appropriate production and supply policies.

(iii) Cooperating fully with a view to creating a sub-regional and regional network of trade information through the exchange of information, encouraging and facilitating the free movement of African traders and businessmen.

(iv) Liberalizing, if possible, the exchange control and allocation system in order to allow importation of essential products. When the national currency is unstable, the possibility of establishing a system guaranteeing balance between the supply of and demand for foreign exchange within the framework of inter-State trade cooperation.

(v) Within the framework of an African Monetary Fund of which the acceleration modalities for its establishment process will be discussed soon by the African Ministers of Finance at their third meeting in Blantyre, Malawi, from 27 February to 3 March 1989, promoting the stability of African currency through efficient stabilization policies, including notably exchange rate regimes, at the national, sub-regional and regional levels. This corroborates the concerns expressed in the meetings of the Group of Seven which were held recently in Washington about an acceptable base for systems of parities of the main currencies within the framework of a real reform of the international monetary system.

(vi) Once the African Monetary Fund is created, promoting the liberalization of exchange regulations in order to eliminate payment restrictions among African countries by favouring free convertibility of national currencies and by fixing parities, and facilitating the harmonization of clearing and payment arrangements presently in force in order to encourage cooperation and intra-African trade.

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Meeting of Intergovernmental Experts
on the African Framework for
Structural Adjustment Programmes

Blantyre (Malawi),
27 February - 4 March 1989

Third meeting of the Conference of
African Ministers of Finance on
the African Framework for
Structural Adjustment Programmes

Blantyre (Malawi), 7 - 8 March 1989

LC/NAIROBI.

REPORT ON THE ACTIVITIES OF THE CONTACT GROUP ON AFRICA'S EXTERNAL DEBT CRISIS

A Note by The General Secretariat of the OAU

E/ECA/TRADE/89/3
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INTRODUCTION

1. It is to be recalled that during the Twenty-first Ordinary Session of the Assembly of Heads of State and Government of the Organisation of African Unity (OAU) held from 18 to 20 July 1985, the Assembly adopted the Africa's Priority Programme for Economic Recovery 1986-1990. That programme inter alia calls upon African countries to press for an international conference on Africa's external indebtedness to be convened as a matter of urgency to provide a forum for international creditors and African borrowers to discuss Africa's external debt with a view to arriving at appropriate emergency, short, medium and long-term measures to alleviate Africa's debt problems. In order to pursue that decision the then OAU's current Chairman and the Bureau of the Twenty-first Ordinary Session of the Assembly were requested to make the necessary contact with the multilateral institutions and the major creditors so as to ensure an early convening of the conference. That decision was not implemented however, as much effort was concentrated on the convening of a Special Session of the United Nations General Assembly to discuss specifically Africa's economic crisis.

2. With a view to examining in depth, Africa's mounting debt and excessive debt-service payments, the Heads of State and Government of the OAU met in their Third Extraordinary Assembly in Addis Ababa, on 30 November and 1 December 1987 which was devoted exclusively to Africa's debt crisis. The 3rd Extraordinary OAU Summit adopted the African Common Position on Africa's External Debt Crisis, in which the Heads of State and Government renewed their call for the convening of an International Conference on Africa's External Indebtedness. The Current Chairman of the OAU was mandated to bring the African Common Position to the attention of the international community so that an international Conference on Africa's External Indebtedness could be convened in 1988. The current Chairman was accordingly mandated to constitute a Contact Group at the level of Heads of State and Government to assist and advise him on how best to convene the international conference.

MANDATE OF THE CONTACT GROUP

3. The main task of the Contact Group was to assist and advise the current Chairman on how best to convene the conference on Africa's External Indebtedness. Consequently its terms of reference consist of the following:

(i) to mobilize the necessary political will in support of the Conference from all parties concerned, and to sensitise the international public opinion to that end;

(ii) to design and propose a framework for undertaking consultations with Africa's creditors, including the multilateral institutions and private lenders to establish contacts with them, with a view to persuading them to participate in the Conference, and to agree with them on issues pertaining to the Conference, such as the dates, venue, duration, agenda and other organisational and procedural matters;

(iii) to establish contacts with, sensitize and exchange information with other developing countries in Latin America and Asia within the context of the Non-Aligned Movement and the Group of 77;

(iv) to decide and agree on the role and responsibilities to be assigned to each member of the Contact Group before and during the conference, especially in the process of preparations for the international conference and in the negotiating process;

(v) to assess the results of the contacts and consultations with a view to determining future course of action, and to report to the Current Chairman on the progress achieved in the preparatory actions for organising the Conference.

COMPOSITION OF THE CONTACT GROUP

4. In accordance with the mandate given to the OAU current Chairman 1987/88, H.E. President Kaunda of Zambia, the Contact Group was constituted in February 1988 as follows:

Algeria, Congo, Egypt, Madagascar, Mali, Nigeria, Senegal, Sudan, Tanzania, Zaire, Zambia and Zimbabwe.

Mali has since taken over the Chairmanship of the Contact Group from Zambia.

5. The Contact Group is at the level of Heads of State and Government of the OAU, and reports only to the OAU Assembly of Heads of State and Government. The present document is however submitted to the 3rd Conference of African Ministers of Finance in recognition of the special competance of this body in all financial and monetary issues, including Africa's external debt problem. Secondly, it is the expectation that the participants in the proposed international conference would be Ministers of Foreign/External Affairs and Ministers of Finance/Economic Planning, and as such, the Conference of African Ministers of Finance should be involved in the aspects of the preparation for the conference. Thirdly, Ministers of Finance are always in contact with Africa's creditors, private and official including multilateral finance institutions, and they should be in a position to contribute to the work of the Contact Group, especially in explaining the African Common Position and in strengthening the argumentation as presented in the Aide Memoire on the International Conference (Doc. CG/IV/CONF/1).

ACTIVITIES UNDERTAKEN

First (INAUGURAL) Meeting (March 1988, Lusaka)

6. The first and inaugural meeting of the Contact Group was held at Ministerial Level in Lusaka, Zambia from 21 to 22 March 1988. It was preceded by a two-day preparatory meeting of experts in the same venue. At that meeting the Group worked out the framework and modalities for convening the international conference on Africa's external indebtedness

and articulated the major objectives and expected outcome of the proposed conference. It also decided on the scope of participation. In addition it formulated its work-programme and timetable and defined the duties and responsibilities of the individual members of the Group, especially the creditor countries and institutions as well as non-creditor countries to be contacted by each Member. Specific assignments were also given to the Joint OAU/ECA/ADB/ACMS Secretariat.

7. The following major decisions were taken by the Contact Group at its first meeting:-

(i) that individual members of the Group should undertake preliminary consultations with countries and organisations assigned to them during the period April/May 1988;

(ii) that during the 48th Session of the Council of Ministers (May 1988) there should be a meeting of the Contact Group at Ministerial level at which they would submit a report on their findings and make a preliminary evaluation of the feasibility of convening the Conference within 1988 as directed by the Summit;

(iii) that the Joint Secretariat should prepare a working document on logistics and financing of the conference for consideration at its subsequent meeting in May 1988; and

(iv) that in order to facilitate the preliminary contacts the current Chairman should issue letters of introduction to Member States of the Contact Group.

SECOND MEETING (Addis Ababa May 1988)

8. In accordance with its established programme of work the Contact Group held its second meeting at Ministerial level in Addis Ababa on May 22, 1988 to deal inter alia with the following matters:

(i) receive and evaluate preliminary reports on missions undertaken by the members of the Contact Group;

(ii) attend to administrative matters of the Group and map out new strategies for future actions of the Group; and

(iii) make recommendations to be submitted to the current Chairman for onward transmission to the OAU Assembly of Heads of State and Government for their approval.

9. During that meeting the Group took note of the reports submitted on sensitization, contacts and consultation missions undertaken by its members to the following countries and institutions: Holland, Italy, Federal Republic of Germany, Belgium, the Scandinavian countries, Austria, France, Greece, Spain, Portugal, the United Kingdom, the Paris Club, OECD, OPEC, UNCTAD, BADEA, the International Monetary Fund and the World Bank.

10. On the whole the Group was of the view that the political authorities contacted were generally aware of the magnitude of Africa's external debt crisis. Although no definitive position was taken, they did not however, believe that the global approach of convening an international conference was appropriate. They tended to think that the case-by-case approach was much more pragmatic within the existing international framework and institutions. Some of the creditors expressed doubts on some of the measures proposed in the African Common Position on Africa's external debt crisis bearing in mind the structure of Africa's debt and the differences that exist among African countries. All the creditor countries contacted requested for detailed technical arguments on various issues covered in the African Common Position, within the context of a thorough preparation which, they emphasised, was necessary for success.

11. In its assessment of the missions undertaken the Contact Group agreed that there was a general reluctance to accepting the approach proposed by Africa which sought to address the problem through an International Conference on Africa's external indebtedness. It was also felt that in order to press Africa's case for the convening of the Conference it ought to undertake much more through preparations and launch an intensive and aggressive sensitization campaign.

DECISIONS OF 24TH ASSEMBLY OF OAU

12. Drawing inspiration from the recommendations of the Contact Group, the 24th Assembly of Heads of State and Government of the OAU decided inter alia to:

(i) mandate the current Chairman of the OAU to continue and intensify efforts to mobilize international support with a view to the convening of the International Conference at a most propitious time but not later than the end of 1989 and to that end, requests the Contact Group established for the purpose to continue to assist the Current Chairman in executing his mandate;

(ii) empower the current Chairman to decide, on the basis of contacts with the States concerned on the holding of an International Conference on Africa's External Debt

(iii) request the Contact Group to meet at Ministerial level in New York during the third week of September 1988 in order to take advantage of the discussion of the Report of the Advisory Group on Financial Flows for Africa, within the context of the Mid-term Review of the Implementation of the United Nations Programme of Action for African Economic Recovery and Development 1986-1990;

(iv) request the Secretariats of the OAU, ECA, ADB and the African Centre for Monetary Studies to update the technical studies on Africa's External Debt and, based on the African Common Position on Africa's External Debt Crisis and on the results of the contacts undertaken, to prepare a paper on the major issues for negotiation highlighting new elements and the unique situation of Africa;

(v) request the joint Secretariat to prepare a technical paper on a Common African Position, taking into account the observations and objections of creditor countries and institutions, for submission to the contact countries and institutions;

(vi) further requested the joint Secretariat to organize a Seminar on the African Common Stand, to be attended by African Banking and Financial Experts selected in their personal capacity.

13. In connection with the above, the Secretary-General of UNCTAD was invited to cooperate with the Joint secretariat of the OAU, ECA, ADB and ACMS.

THIRD MEETING (New York September 1988)

14. In conformity with the directives of the 24th Assembly of Heads of State and Government of the OAU as referred to above, the Third Ministerial Meeting of the Contact Group was held on 26 September 1988 in New York. That meeting, inter alia, considered:

(i) the reports on contacts made since the second meeting of the Contact Group in May 1988;

(ii) the recommendations of the meeting of Experts on the reactions of the creditor community to the proposal for an International Conference on Africa's External Indebtedness.

(iii) Future Work-programme of the Contact Group.

15. After considering mission/contact reports submitted to it by members, the Contact Group proceeded to examine the basic working document prepared by the Joint Secretariat. It requested the Joint Secretariat to re-examine, revise, restructure and resubmit the document to the 4th meeting of the Contact Group. The revision was to cover all comments, recommendations made at the meeting, as well as recent developments on Africa's external debt problem, including the decisions of the UN Ad Hoc Committee of the Whole on the review of the

implementation of the United Nations Programme of Action for Africa's Recovery and Development (UNPAAERD), the Toronto Summit and the 1988 annual Joint meeting of the World Bank and IMF held in West Berlin. The Group decided that other recent developments on the African debt issue, including those at the level of the Development Committee of the IMF should be taken into account in the revision. Furthermore, it directed that the title of the document should be changed to indicate that it is an Aide Memoire. As regards the organisation of the international seminar on the African Common Position the Contact Group agreed that there should be only one seminar on the African Common Position to be organized in accordance with the mandate of the Twenty-fourth OAU Summit as contained in Resolution AHG/Res.175(XXIV).

16. It was also agreed that the financing of the Seminar would be considered at the 4th meeting of the Contact Group on the basis of a document to be prepared by the Joint Secretariat on possible sources of finance.

17. Regarding the future Work Programme of the Contact Group the meeting decided that the 4th meeting should take place in Addis Ababa in February 1989 at Ministerial Level so as to review the actions taken by the members of the Group and adopt the revised Aide Memoire. Preparation for the Seminar were also to be reviewed. It was nevertheless decided that members of the Contact Group who would be attending the November 1988 Session of the Permanent Steering Committee should meet to exchange views on the document and to provide further guidance to the Secretariat.

MEETING OF SOME REPRESENTATIVE OF MEMBER STATES OF THE CONTACT GROUP (Addis Ababa, November 1988)

18. The meeting took place in Addis Ababa on 25 November 1988. The main purpose was to examine preparatory arrangements relating to the organisation of the international conference on Africa's External debt Crisis. But since the relevant document was not yet available in the required working languages efforts were directed at reviewing the Aide Memoire on the International Seminar. In that connection the meeting examined the major issues involved in the organisation of the Seminar, such as date, venue, cost of organising the Seminar, number of participants and the substantive issues to be discussed in the Seminar.

19. On the venue the Minister of State for Foreign Affairs of Egypt informed the meeting of Egypt's readiness to host the Seminar in Cairo but not calier than September 1989.

20. Regarding the experts to be invited to the Seminar the meeting agreed that a total of 30 African experts should be invited in their personal capacity to participate in the Seminar; 20 from Africa and 10 from outside Africa. It was further agreed that in addition, government experts from the OAU Member States should participate in the Seminar on behalf of their Governments which would be responsible for their participation.

21. As regards the estimated cost of organising the Seminar the Joint Secretariat was directed to prepare alternative draft estimates for organising the Seminar either in Addis Ababa, Abidjan or Cairo, in order to facilitate comparison of those costs between the three prospective venues.

22. The Joint secretariat was requested to finalise and translate into French the Aide Memoire on the Seminar and circulate it to all member States before 15 December 1988 together with the Aide Memoire on the International Conference, in readiness for the meeting of the Contact Group in February 1989. These two documents are also submitted to the Ministers of Finance, meeting in their 3rd Conference in Bamako.

STATUS OF PREPARATIONS FOR THE INTERNATIONAL SEMINAR ON THE AFRICAN COMMON POSITION ON AFRICA'S EXTERNAL DEBT CRISIS

23. As of now it has been confirmed by the Government of Arab Republic of Egypt that it will host the Seminar on the African Common Position in Cairo from 9 to 11 October 1989.

24. In accordance with the directives of the meetings of the Contact Group held in September in New York and in Addis Ababa in November 1988 respectively the Joint Secretariat met twice to revise the basic working documents. Accordingly the following documents were circulated to member States of the Contact Group and other interested parties in readiness for their 4th meeting:

(i) An Aide Memoire on the proposed International Conference on Africa's External Indebtedness (Document CG/IV/Conf.1)

(ii) An Aide Memoire on the International Seminar on the African Common Position on Africa's External Debt Crisis (Document CG/IV/SEM.1)

(iii) Report on the meeting of the representatives of member States of the Contact Group on Africa's Debt Crisis (Document CG/MTG/RPT.1).

25. In preparation for the seminar and in accordance with the directives of the Contact Group efforts have been made by the Joint Secretariat to identify African and non-African experts. As of now invitations have gone out to ten Eminent Persons. Out of this number three are expected to write papers on the specific issues assigned to each of them.

NEW DEVELOPMENTS ON THE SUBSTANTIVE ISSUES REGARDING AFRICA'S DEBT

26. The most significant development on this issue is the Agreement reached at the Toronto Summit of the Group of 7 most industrialized countries held in June 1988. Under the Toronto Agreement creditors have achieved consensus on rescheduling official debt of those (dent distressed) countries within a framework of comparability that allows official creditors to choose among concessional interest rates usually on shorter maturities, longer repayment periods at commercial rates, partial write offs of debt service obligations during the consolidation period, or a combination of these options». The Paris Club was urged to work out the modalities for implementation.

27. The OAU General Secretariat has received a letter from the British Ambassador to the People's Democratic Republic of Ethiopia in which the proposal of the British Government has been stated. The Ambassador informed the Secretariat that the scheme agreed to in Toronto represents one important element in Britain's response to the problems of external indebtedness of the poorest countries, especially in Africa.

28. In his address to the United Nations General Assembly H. E. Mr. Mikhail Gorbachev the Leader of the Union of Soviet Socialist Republics stated that the burden of external debt constituted one of the greatest problems confronting the world and that the Soviet Union was prepared to institute a lengthy moratorium of up to one hundred years on debt servicing for the least developed countries (LDCs). In some cases they were even prepared to write off those debts altogether.